July 2020

The Quarterly

With this commentary, we plan to communicate with you every month about our thoughts on the markets, some snap-shots of metrics, a section on behavioural investing and finally an update on MacNicol & Associates Asset Management (MAAM). We hope you enjoy this information, and it allows you to better understand what we see going on in the market place.

"*There is nothing wrong with America that cannot be cured by what is right with America*."

- President Bill Clinton

Index:		**Year-to-Date:**	
S&P/TSX:		-9.1%	
NASDAQ:		12.1%	
Dow Jones:		-9.6%	
S&P500:		-4.0%	
Interest Rates:	**Canada**		**USA**
90-Day T-Bill:	0.19%		0.15%
5-Year Bond:	0.38%		0.31%
10-Year Bond:	0.55%		0.68%
30-Year Bond:	1.03%		1.43%

Economic Data:

- More Canadians head back to work in May and June than expected
- US labour market also increases ahead of expectations as 4.8 million net new jobs were created in June
- Stocks globally rebound in Q2, 2020
- Canadian Dollar back into the $0.74 range
- Gold up $200 in Q2, 2020 at $1,800/Oz.
- Crude Oil in a trading range around $40/bbl.

Valuation Measures: S&P 500 Index

Valuation Measure	Latest	1-year ago
P/E: Price-to-Earnings	21.37	22.33
P/B: Price-to-Book	3.38	3.25
P/S: Price-to-Sales	2.14	2.10
Yield: Dividend Yield	1.91%	1.85%

Year-to-date Performance, by Sector: June 30th, 2020

S&P/TSX Composite	-9.1%
NASDAQ	12.1%
Dow Jones Industrials	-9.6%
S&P 500	-4.0%
Russel 2000 (Small Caps)	-13.6%
MSCI EAFE	-12.6%
Crude Oil Spot (WTI)	-38.3%
Gold Buillion ($US/Troy Ounce)	16.7%
SOX Semi-conductor Index	10.5%
VIX Volatility Index	98.4%

Source: Canaccord Genuity Capital Markets & Thomson Reuters

Foreign Exchange - FX

We continue to survey all the Banks and some Custodians to compare Foreign Exchange Rates charged. As you can see in the chart below some of these Institutions are charging considerably more than previous months when we did our first comparison. We tried to include some other firms, but they do not post public rates online or require a membership fee. Let us know if we have left any organization off here and we will try to include in future publications.

As of July 9, 2019 4:40 PM	$ 5,000	Cdn		
Banks	**Rate**	**Buy USD**	**Cost**	**% Difference from Spot Rate**
CIBC	**No Public Rate Posted Online**			
Interactive Brokers	**1.3584**	**$ 3,681**	**$ -**	**0.0%**
Laurentian Bank	**No Public Rate Posted Online**			
National Bank	**1.3711**	**$ 3,647**	**$ (34)**	**-0.9%**
Raymond James	**1.3700**	**$ 3,650**	**$ (31)**	**-0.9%**
Royal Bank	**1.3870**	**$ 3,605**	**$ (76)**	**-2.1%**
Scotia	**1.3919**	**$ 3,592**	**$ (89)**	**-2.5%**
TD	**1.3939**	**$ 3,587**	**$ (94)**	**-2.6%**
Spot Rate	**1.3584**	**$ 3,681**	**$ -**	**0.0%**

Raucous ride, not so robust rebound?

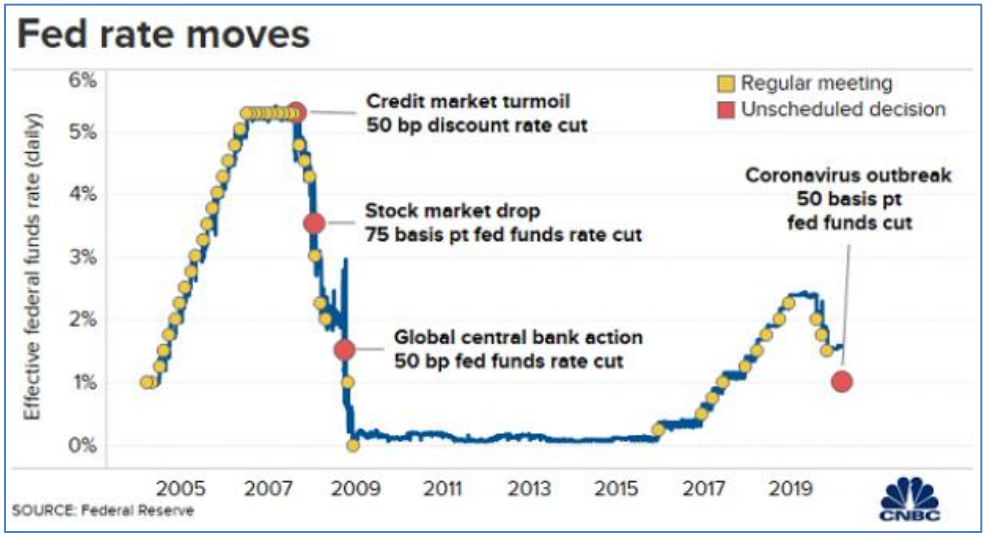
Even if you do not follow the stock market regularly, you probably do know that it plunged big-time in late March on fears that the coronavirus pandemic would halt an economic expansion that was 11 years in the making. Mandatory coronavirus shut downs and travel restrictions eradicated not only a sizable chunk of corporate profits but tens of millions of jobs that not that long ago seemed to punctuate a decades low unemployment rate. Since those worrisome days in late March however, stocks have performed well perhaps a bit too well. Coronavirus continues to spread and several market-based indicators of economic performance offer investors mixed messages.

Was the stock market's rebound off the March 23rd low a sign of a mature, battle hardened warrior looking coronavirus dead in the eyes or was the more than 40% rise from the bottom something entirely different? As in a marriage, the truth is somewhere in the middle...

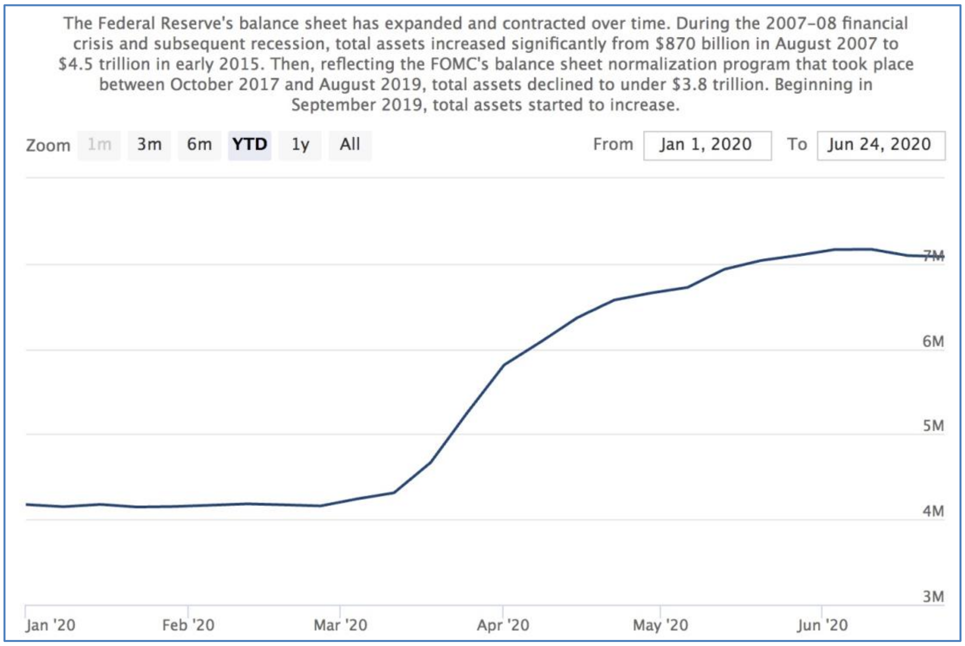
Coronavirus is no joke and we have written about its dangers before, each time failing to capture the immense human toll often lost on people who focus on financial markets day in and day out. Many industries were wiped out almost overnight as governments around the world tried to stem the spread of the virus. Vigilance slowed the spread of the virus, and we feel that this coupled with low valuations and stealthy action on the part of some intrepid investors helped the stock market to the point where it is today. Another factor that we feel explains the market's impressive rebound and its more recent listless behavior is the combination of decisive fiscal and monetary policy and the idea that both might eventually expire or tapper off. We parse the role of fiscal and monetary policy below in order to hopefully guide us to an assessment of just how "robust" the recovery really is. Fiscal policy is relatively straight forward to grasp: the government introduced a variety of emergency measures that helped keep people in their homes and businesses a float. The measures helped, but are set to either roll off in July and that has many people wondering what will happen if the virus continues to gain force into the fall? Treasury Secretary Mnuchin has pledged support, but he has also promised warnings to those who feel a second bailout will accompany a second wave…

[Steven Mnuchin has been secretive about the companies that received Government bailouts. Less of a mystery is how Mnuchin feels about those corporations who dare to "roll the dice" with tax payer monies: moral hazard at your own hazard.]

For their part, the US Federal Reserve came to the aid of the American people with a series of emergency rate cuts and other supports, which frankly assist only the rich [the average American does not have a sizable investment portfolio and often lives from pay-cheque to pay-cheque].



[CNBC sometimes gets criticized for sensationalizing financial news media. I happen to think they do a fine job of showing things like the plight of the Fed Funds rate over the past decade and a half in picture format very well.]



[This is the US Federal Reserve's Balance Sheet and it is pretty sensational in its own way. For starters it's in trillions. What's more, if you follow the balance sheet from late March until today the performance of the stock market begins to make much more sense while being much less sensational.]

As you can see, Fed support worked, but markets hit a brick wall the moment the Fed took its monetary foot off the economic accelerator.

[US Federal Reserve Boss Jerome Powell announced that the Fed would begin buying not only Corporate Bond ETFs but individual corporate bonds as well.]

[The stock market recovered like a battle hardened warrior until the 1st week in June. For that point on it seemed a lot more mortal.]

Super imposing the chart of the stock market on the previous page against the graph showing the level of bond buying by the Fed hammers home a crucial point, which is that the "renaissance" in the stock market is not so much a transition from economic doom to economic expansion as it is cheap money forcing capitalists into risk assets. Some might argue that the eye of the storm has passed and stocks are right to challenge all-time highs once more. Recent (and positive) surprises in payrolls along with upward revisions to GDP are encouraging. But both statistics have a long way to go before changing our skeptical minds and cautious portfolio positioning. The simple fact is this, equity markets have rallied faster than many would have guessed and they have done so mainly [we might even say "entirely"] with what amounts of government handouts and liquidity infusions. Sure, a handful of intrepid hedge funds and private equity gurus got the timing right, but this is hardly the sort of backdrop for what constitutes a "robust" recovery.

The economy hasn't gotten stronger, money has gotten cheaper.

[Phoenix, AZ based Nikola Corporation is set to become the world's 1st zero emission vehicle manufacturer. And get this…they are going to be making transport trucks. Here's hoping they make LOTs of these futuristic 'big rigs". The stock market has already given Nikola a $17 Billion valuation…the MacNicol Investment Team doubts that established players like Mercedes-Benz, Volvo and Freightliner are worried: now do you believe me when I say that the economy hasn't gotten stronger and that money has gotten cheaper?]

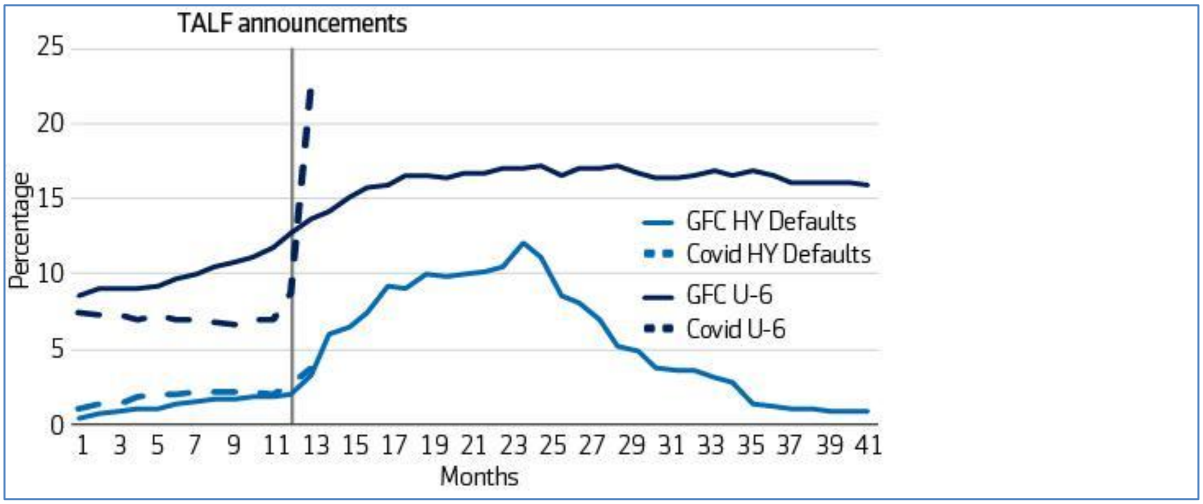
Investing cautiously is not something we came up with out of the blue. At MacNicol and Associates, we recognized nearly two decades ago that protecting client capital from downside risk is *the* key to maintaining a smooth ride when a raucous one is on offer by financial markets. Less money lost during bad times, means you'll be further ahead at all times. We certainly appreciate the lengths to which fiscal and monetary authorities went to stabilize financial markets in March and April. But we are far [quite far in fact] from letting our guard down when it comes to managing your money. Indeed part of the recovery in financial markets may have been driven by the natural tendency for capital to find a low cost, high expected return home. It's just unfortunate that as is the case with Coronavirus vaccines themselves, all that's offered is hope.

The MacNicol Investment Team

Not out of the woods yet...

If the letters **CMBS** mean absolutely nothing to you don't worry you are not alone. **Commercial Mortgage-Backed Securities** (**CMBS**) are fixed-income investment vehicles backed by mortgages on commercial real estate (CRE) and they account for only 2% of the overall U.S. fixed income market. Yet despite their puny size, CMBS are an important source of liquidity to real estate investors and commercial lenders alike. CMBS take the form of bonds and the loans that form a single CMBS act as the collateral in the event of default, with principal and interest passed on to investors. The loans are often parked in some sort of master trust structure, and diversified across term, property type, and size. The underlying loans that are themselves securitized into CMBS encompass loans for buildings like apartments, factories, hotels, office buildings and shopping malls. Although CMBS lurk beneath most CRE – they tend to surface when things go wrong. And while a lot is quite wrong in the CMBS world a closer inspection seemed like a worthwhile exercise given that the CMBS market is a proxy for overall liquidity in the area of debt capital markets of greatest interest to CRE investors.

The S&P 500 has recovered 90% of its post sell off high. High yield corporate bonds have rebounded by roughly 70%. But the CMBS market has lagged materially perhaps due to the fact that default rates (now) mirror the all-time highs last seen during the global financial crisis.

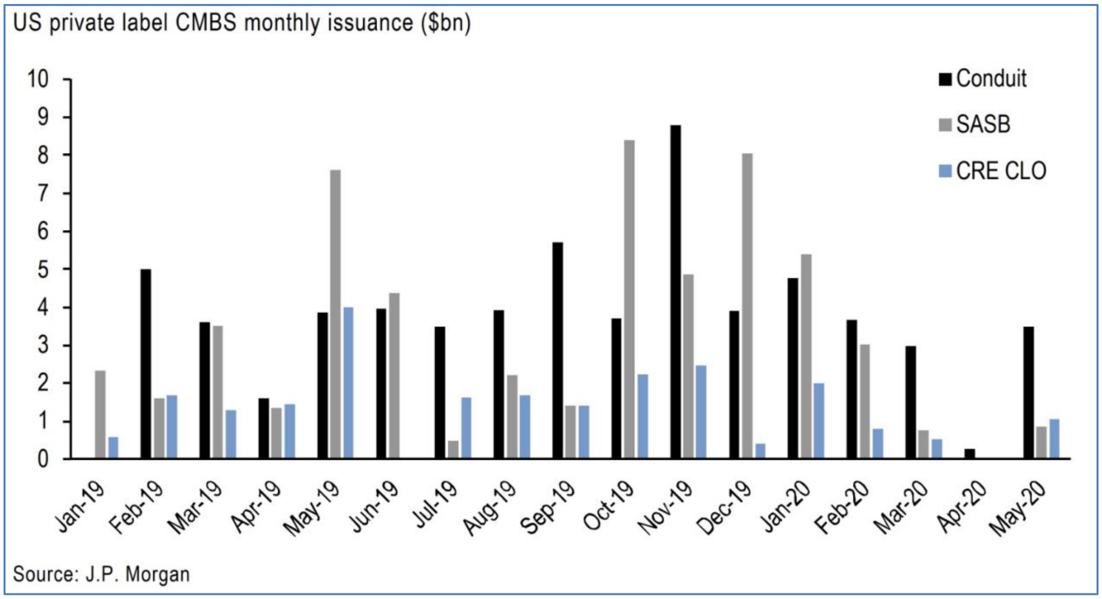


[This chart demonstrates that defaults on the U-6 category of CMBS now match the levels seen during the global financial crisis. The chart also shows that U-6 CMBS defaults are also materially outpacing defaults in the junk bond market in general. Source: JP Morgan.]

Corporate bonds purchases by the Federal Reserve (be they a replacement for or complimentary to corporate bond ETF purchases) will be a tailwind for corporate bond prices and hopefully the thinking goes for CMBS also. However, at a fundamental level, the risks that remain in CRE lead to delinquent CMBS. If the CMBS market was not supported, wider spreads would be a fact of life most CRE investors and lenders would face. We are less optimistic further down the credit stack as there is less support and considerable uncertainty for lower tier CRE sectors. And so CMBS risk premiums should remain elevated, despite lagging high yield and equities.

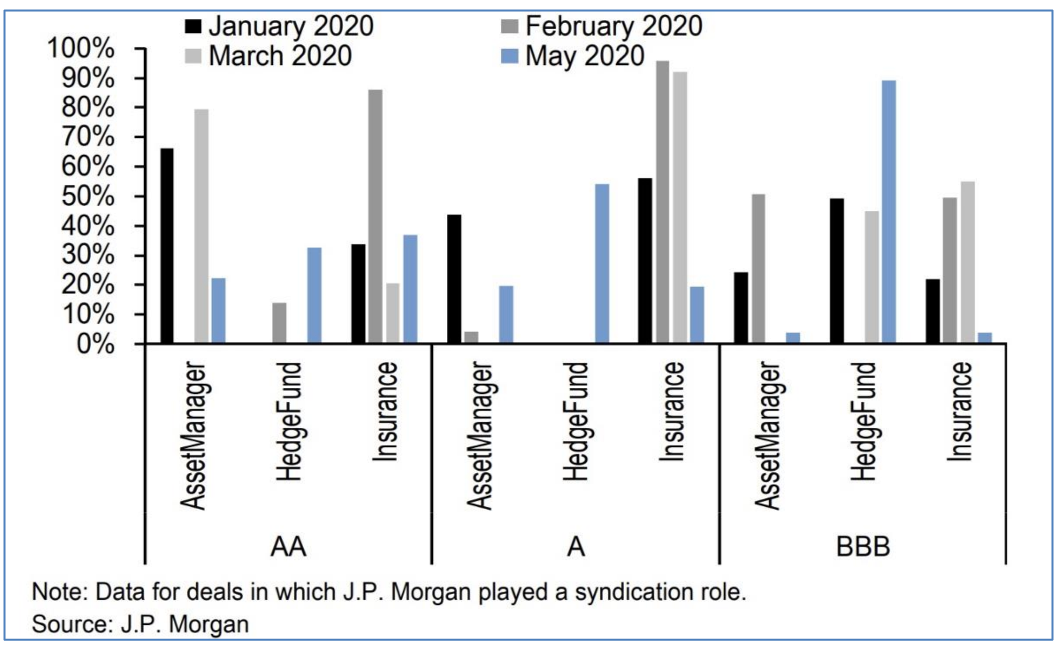
A key variable is the CMBS arena is the CAREs Act coming offline. Most Economists figure a one-time boost of roughly $300 billion of disposable income in 2Q. And the expanded unemployment insurance program added $13 billion to April income. The vast majority of the money came from the Pandemic Unemployment Compensation benefits, which supplement other programs by $600 per week. However, this is set to expire at the end of July and could have a meaningful impact, if not extended in some form. Adding to uncertainty is the looming Presidential election.

The good news is that following a brief period in which the CMBS market [literally] froze, we are beginning to see an uptick in securitizations. It's definitely a start.



[The CMBS market literally stopped in April as the CRE world braced itself for the worst.]

Higher yields enticed investors back into the CMBS market in May and securitizations are popping up in some of June's data. The composition of CMBS investors also gives us hope that capital inflows will continue to support CRE financing. Analysts from JP Morgan show that in May, Hedge Funds were especially active in the lower rated BBB space. Hedge Funds are viewed as opportunistic investors when compared to Asset Managers or Insurance Companies. And though yield spreads have necessarily widened due to the uncertainty underpinning CRE, we view the trend in deal flow as constructive. And we saw a similar trend following the 2007/2008 housing crisis when several hedge funds and private equity firms stepped in to provide badly need capital.



[Delinquencies in the CMBS space are on par with levels last seen during the Global Financial Crisis. This is a piercing data point showing just how dire the situation is in certain areas of CRE. At the same time, investors with an eye to the future should consider that investment capital is flowing into the CMBS market. The blue bars in the data above show that while Asset Managers and insurance companies took a pass on CMBS deals in May the Hedge Fund world "doubled down" on their desire for BBB rated product. Another positive is that insurance companies were relatively consistent in their need for higher rated CMBS product, which plays in our favour given our preference for Class A buildings.]

As you can tell there is a lot to be fearful of in the debt capital markets but also much to ponder for those who look beyond where capital is and instead focus on where it is going. We are therefore cautiously optimistic on CRE. The simple fact that securitizations are happening at all is a huge positive for CMBS and CRE. A move by Asset Managers to step back into the CMBS market in a more material way would meaningfully raise our confidence too. We certainly think that does eventually happen, perhaps sooner than later. Deals backed by post-corona originations should be more conservatively underwritten. Buy-and-hold yield investors such as insurance companies are likely to remain a large presence across the AA and single-A rated space as they have traditionally, any material reduction in demand would indeed concern us. Hedge Funds should assist the more peripheral CRE product types like retail, hotel and Tier 2 office based on historical precedent. CMBS price action followed a similar path in the aftermath of the global financial crisis. In early 2009, TARP (Troubled Asset Relief Program) sparked a massive rally across risk assets in general and CMBS were no different. We saw (some) CMBS asset prices climb by 400% from the March 2009 lows into early 2011. Shortly after that point, the European sovereign debt crisis derailed the rally and caused various tranches of CMBS to traverse different paths as fundamental considerations specific to the collateral began to inform trading views more than a simple hunch on yields. The current price action in CMBS (for example the mere fact that securitizations are happening at all) is encouraging and best thought of as an initial rally off the lows before "shifting gears" to a slower moving quest for quality collateral.

Any discussion of CRE is incomplete without a survey of debt capital markets. The recent positive surprises in the payroll numbers and upward revisions of GDP are encouraging but equity markets have rallied faster than many would have guessed. CMBS securitizations are happening and opportunistic investors such as Hedge Funds are active buyers of lower graded tranches with Asset Managers and Insurance Companies doing their part in the higher rated spaces. If we were to sum up CRE and CMBS market on which it stands, we would say that the easy money in this economic cycle has probably been made but that does not mean that more money cannot be made for investors who combine a little digging and a lot of patience. As with individual properties, buyers of CMBS will have to look more closely at the quality of the collateral and compare the percentage of loans within a given pool of assets that are delinquent or close to becoming delinquent.

The MacNicol Investment Team

Investment Aboulomania

Aboulomania is a mental disorder in which patients display pathological indecisiveness. It is often associated with anxiety, depression or stress, and originates in the pre-frontal cortex of the brain (red arrow). Pathological *investment* indecisiveness can be brought on by financial markets that offer investors mixed messages, and it certainly doesn't make you a psychopath. In the previous article, we attempted to point out that while near-term action in the CMBS market was encouraging but far from a "green light". We also pointed out that a start-up transportation company called Nikola already has a stock valuation near $17 billion despite being miles away from disturbing, leave alone challenging industry heavy weights like Mercedes-Benz, Volvo and Freightliner. And so investors can be forgiven from not knowing what to do. Fortunately, we meet with investors who suffer from investment aboulomania. The MacNicol Team is not only skill at investing but at advising clients and prospective clients on what sort of investing relationship works best for them. With almost 20 years as Canada's independent choice for investors, we have helped hundreds of families with their investments and their investment relationships. Pathologically saving for your future is never a bad thing, but worrying about what to do with your money can be. Let MacNicol & Associates help channel your discipline without missing opportunities for growing your money.

The MacNicol Investment Team

Firm News

We are pleased to announce that we have hired a Summer intern in the role of Research Associate. Omair Khan has an undergraduate degree from the University of Toronto in Business Administration with a focus in Finance. He is currently enrolled at Osgoode Hall Law School. He has worked at a variety of jobs in the past, including two years for the Ontario Teachers' Pension Plan. We are excited to have Omair join our team.

Dave and Diane will be busy at the end of July because their dog Penny, a three year old Vizsla, will be having puppies. This is a completely new experience for both of them and they are very excited to meet the newest members of their family.

MacNicol & Associates Asset Management Inc.